

Internal Revenue Service

Department of the Treasury

District
Director

Delaware-Maryland District

31 Hopkins Plaza, Baltimore, MD 21201

Person to Contact:

Contact Telephone Number:

In Reply Refer to:

Date: DEC 14 1999

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

You incorporated in [REDACTED] for the following purposes:

- a) To affiliate with the [REDACTED] and the [REDACTED] for their outreach programs and general oversight of the frail, elderly, disabled, mentally ill and/or retarded and veterans living in leased or owned facilities of said Corporation.
- b) To promote the general welfare of persons with problems common to the act of aging, disabilities (mentally and/or physically) and veterans.
- c) To plan, promote and assist in the establishment, maintenance and operations of training and education center or clinic's for the education, social and physical improvement of such handicapped persons.
- d) To sponsor a campaign of education and training whereby the general public will be appraised of the problems and needs of such persons.
- e) To initiate and foster state and local actions for the benefit of such persons.
- f) Generally, to take any action which promotes any and all of the foregoing purposes.

The governing body is comprised of four individuals. The related individuals [REDACTED], President and [REDACTED], Treasurer control the organization.

Income is derived from [REDACTED], and food stamps, the [REDACTED] and fundraising. Expenditures are related to operations, salaries, furniture replacement, leasehold improvements, travel and rent.

It is noted that [REDACTED] is a privately owned for-profit corporation transferring its liabilities, which exceeds its assets, to this organization.

The operations of the organization are conducted in three houses: [REDACTED]

[REDACTED] and [REDACTED]

[REDACTED] is owned by [REDACTED]

owns [REDACTED] with [REDACTED] as the [REDACTED]

The activities of the organization are to provide three meals daily, laundry, transportation to medical facilities and oversight with acts of daily living, i.e. medicines at proper times, bathing and dressing.

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations which are organized and operated exclusively for charitable, religious, and educational purposes. no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not organized or operated for any purpose under section 501(c)(3), unless it serves a public rather than a private interest. Thus to meet the requirements of this subparagraph, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization or persons controlled, directly or indirectly, by such private interests. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes, if more than an insubstantial part of its activities serve private interests.

In Est. of Hawaii v Commissioner, 71 TC 1067, the non profit organization engaged in activities relating to "est" programs involving training, seminars, lectures, etc., in areas of intrapersonal awareness and communication. Such activities were conducted under licensing arrangements with for-profit corporations. The courts held that although the activities were educational in nature, the non-profit served the commercial purposes of the for-profit. Thus the non-profit was not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code.

In Hancock Academy of Savannah, Inc. v Commissioner, 69 TC 488, the founder of a for-profit entity formed a non profit corporation to take over the educational functions of the for-profit. The non-profit assumed an excessive liability of the for-profit. The court found the academy failed to meet the requirements of section 501(c)(3).

In John Marshall Law School and John Marshall University v US, 81-2 USTC, an organization that operated a law school and university did not qualify as an exempt organization because a portion of the organization's net earnings inured to the benefit of the private individuals who operated the organization and their families. The corporation contended that the benefits inuring to the individuals were reasonable compensation for the services they performed, but the court concluded that the payment of personal expenses purchases and interest-free loans involved here far exceeded an ordinary and necessary level of compensation.

In Texas Trade School v Commissioner, 30 TC 642, 646-647, Exemption was denied when leasehold improvements were made to property owned by the principal of the corporation.

Revenue Ruling 76-441, Cumulative Bulletin, 1976-2, page 147 held that a nonprofit organization takes over a school's assets and its liabilities, which exceed the value of the assets and include notes owed to the former owners and current directors of the school, is serving the director's private interest and is not operated exclusively for educational and charitable purposes.

Additional clarification of your activities revealed that [REDACTED] filed [REDACTED]

One of the properties owned by [REDACTED], [REDACTED] has outstanding delinquent taxes.

The rents for the three properties, per the lease agreements, are [REDACTED] [REDACTED] and [REDACTED] are properties owned [REDACTED]

[REDACTED] owns all furniture for the houses. The organization is responsible for repairs and replacement of the furniture, in addition, to leasehold improvements.

[REDACTED] states that she is not being paid a salary but her compensation is being accrued until exemption is granted. However this statement is belied by Forms 1120 and 990 filed by the applicant.

The contract between [REDACTED] as the [REDACTED] and as the employee revealed that:

- (a) She will be paid a salary of \$[REDACTED] per month which will accrue until the corporation can disburse the funds,
- (b) The corporation will pay \$[REDACTED] a month to lease [REDACTED] and maintain the property & furnishing. [REDACTED] will accept partial rental fees in the amount \$[REDACTED] (the amount of the mortgage) until the corporation can pay the full rental fee.
- (c) The corporation is responsible for repaying a \$[REDACTED] borrowed by [REDACTED] to pay back taxes and "other items".
- (d) Any withdrawals from the corporation are used to repay personal operational loans secured by [REDACTED] from individuals.
- (e) [REDACTED] will donate her time as manager of a home at [REDACTED] until the corporation can hire a manager. (The home at [REDACTED] was not enclosed as part of this application).

Based upon the facts submitted we hold that you do not qualify for exemption.

ISSUE 1 - LEASEHOLD IMPROVEMENT/TRANSFER OF LIABILITIES

Your Form 1023, Forms 990 and 1120 reflects expenditures for leasehold improvements. When clarification of the expense was requested your response in letter dated [REDACTED] was: "The expense for leasehold improvements has been removed. This was a payment to a contractor for the septic tank. All properties being used have been improved by the lessor [REDACTED] at her expense."

This statement refutes evidence submitted in Form 1023. We hold that [REDACTED] is similar to Texas Trade School and expended its income to improve property not owned by the corporation.

In addition, the corporation has and will incur liabilities though past/current personal loans of [REDACTED]. Hancock Academy

ISSUE 2 - INUREMENT/PRIVATE BENEFIT

The inurement proscription contained in Regulations 1.501(c)(3)-1(c)(1) states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Inurement is likely to arise where the financial benefit represents a transfer of the organization's financial resources to an individual solely by virtue of the individual relationship with the organization without regard to the accomplishment of exempt purposes.

[REDACTED]

Inurement of income is strictly forbidden under section 501(c)(3) without regard to the amount involved. This proscription applies to persons who because of their particular relationship with an organization have an opportunity to control or influence its activities. Such persons are considered "insiders" for purposes of determining whether there is inurement of income. Generally, an organization's officers, directors, founders, and their families are considered "insiders".

A federal court of appeals held that the term "inurement": "may include more than the term net profits as shown by the books of the organization or than the difference between the gross receipts and disbursements in dollars" and that "[p]rofits may inure to the benefit of shareholders in other ways than dividends. See Northwestern Municipal Ass'n v Commissioner.

Evidence submitted in your Form 1023 and subsequent documentation revealed that [REDACTED] entered into a loan agreement that enables her to compensate herself on an accrual basis; requires the corporation to repay her personal loans and repair/maintain her privately owned assets. SUPRA John Marshall Law School and est. Hawaii

Furthermore, [REDACTED] lease agreements for the rented properties are not arms-length. In fact, the inflated rental fee for [REDACTED] inures to her benefit through relieving her of her financial responsibilities.

Although the purported purpose of the organization could be within the purview of section 501(c)(3) of Code, your method of operation does not meet the requirements of the Regulations and/or Code.

Based upon cited court cases, the regulations and Code, we hold that your organization has excessive private benefit and inurement, thereby, defeating exemption.

Therefore, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate State officials.

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If someone who is not one of your principal officers will represent you, that person will need to file a power of attorney or tax information authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(L)(2) of the Code provides, in part, that "A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

If you have any questions, please contact the person whose name and telephone phone number are shown in the heading of this letter.

Sincerely,

District Director

Enclosure: Publication 892

cc: [REDACTED]